Nordic Credit Rating

FINANCIAL INSTITUTION

Sweden
15 Apr. 2024

Danske Hypotek AB (publ)

Full Rating Report

COVERED BOND RATING

AAA

ISSUER RATINGS

LONG-TERM RATING

A

OUTLOOK

Stable

SHORT-TERM RATING

N2

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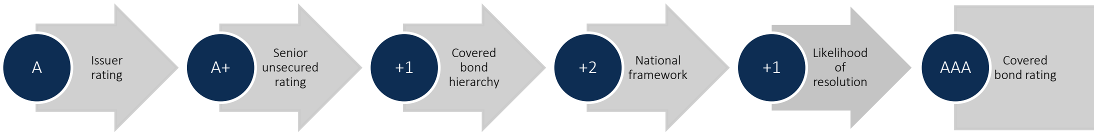
RATING RATIONALE

Our 'AAA' issue rating on covered bonds issued by Sweden-based mortgage company Danske Hypotek AB (publ) is ultimately based on our 'A' issuer rating on the company, which in turn reflects its ownership by the Danske Bank A/S bank group (Danske Bank) and its vital funding role for the group's retail and corporate mortgage portfolio in Sweden. Our covered bond ratings are supported by our 'aaa' qualitative assessment and our analysis of the support available from the cover pool, which indicates 'AAA' level support for bondholders in the unlikely event that the pool were to become a standalone entity.

Figure 1. Danske Hypotek covered bond rating components



Given the stable outlook on the issuer rating on Danske Hypotek, we expect the covered bond ratings to remain stable. This reflects our view that Danske Hypotek and Danske Bank would maintain their status as systemically important financial institutions with a very high likelihood of resolution in the event of failure, which would exclude the bail-in of covered bonds.

RATING STRENGTHS:

- Issuer and group creditworthiness, reducing downgrade risk for covered bonds.
- Strong national and European protections for covered bonds.
- Danske Hypotek's maintenance of material overcollateralisation and a clean pool via transfers of problem loans to its parent.

COVERED BOND RATING DRIVERS:

- Change in single point of entry resolution for Danske Bank.
- Multiple-notch reduction in NCR's issuer rating on Danske Hypotek, due to a deterioration in our assessment of Danske Bank.
- Reduced security in covered bond assets.

Figure 2. Cover pool characteristics, Q4 2021–Q4 2023

	Q4 2021	Q2 2022	Q4 2022	Q2 2023	Q4 2023
Eligible cover pool assets (SEKbn)	121.3	129.1	129.5	133.4	139.5
Outstanding covered bonds (SEKbn)	98.1	105.8	104.6	113.7	107.7
Legal overcollateralisation (%)	23.7	22.0	21.8	15.4	27.5
Average loan seasoning (years)	4.7	4.7	4.9	5.0	5.1
Average bond maturity (years)	2.6	2.4	2.7	2.6	2.9
Average loan size (SEKm)	1.04	1.10	1.08	1.12	1.16
>60 day past-due loans (bps)	0.0	0.0	0.0	0.0	0.0
Weighted-average LTV (%), residential	54.0	53.0	58.0	59.0	58.7
Owner-occupied share, residential (%)	97.0	97.0	96.0	96.4	96.4
Priority liens, residential (%)	99.0	99.0	98.8	99.0	98.7
Share of commercial mortgages (%)	0.0	0.3	0.2	0.3	0.3
Weighted-average LTV (%), commercial	0.0	44.0	38.0	39.0	40.4

Source: Danske Hypotek's European Covered Bond Council Harmonised Transparency Templates (ECBC HTT). LTV–loan to value.

Figure 3. Residential loan balance by property region (SEKbn), 31 Dec. 2023

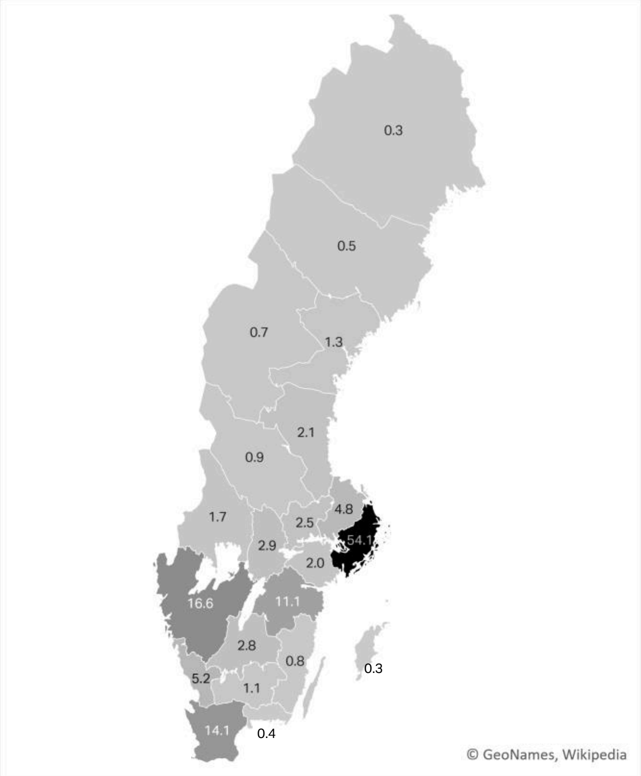


Figure 4. Weighted residential mortgage LTV by property region (%), 31 Dec. 2023

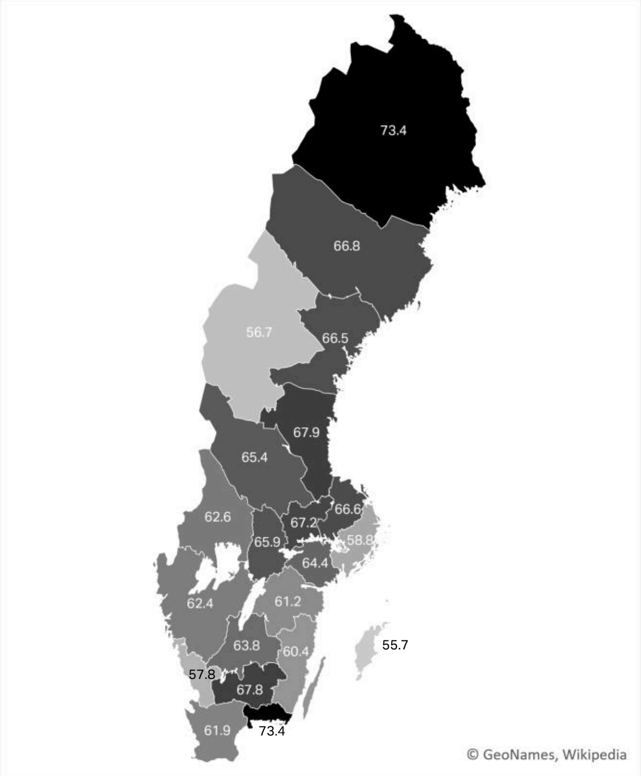


Figure 5. Commercial and multi-family mortgage loan balance by property region (SEKbn), 31 Dec. 2023

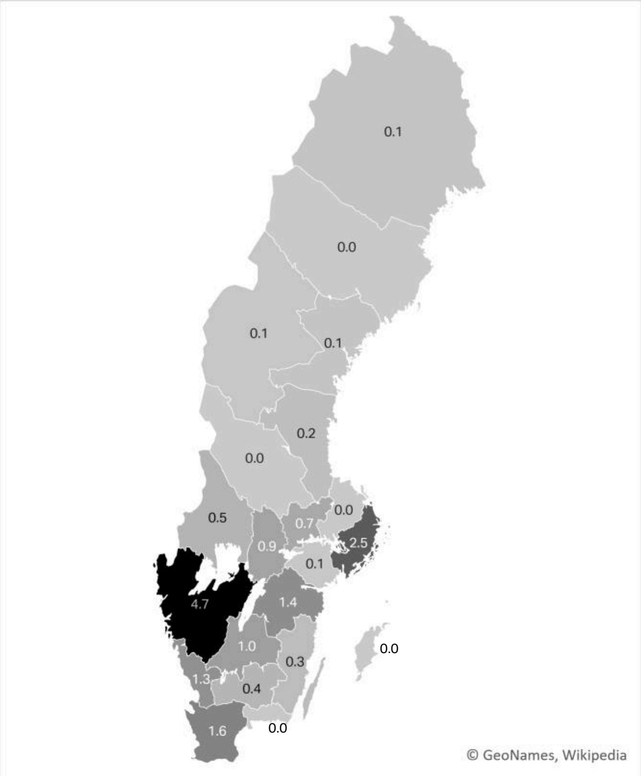
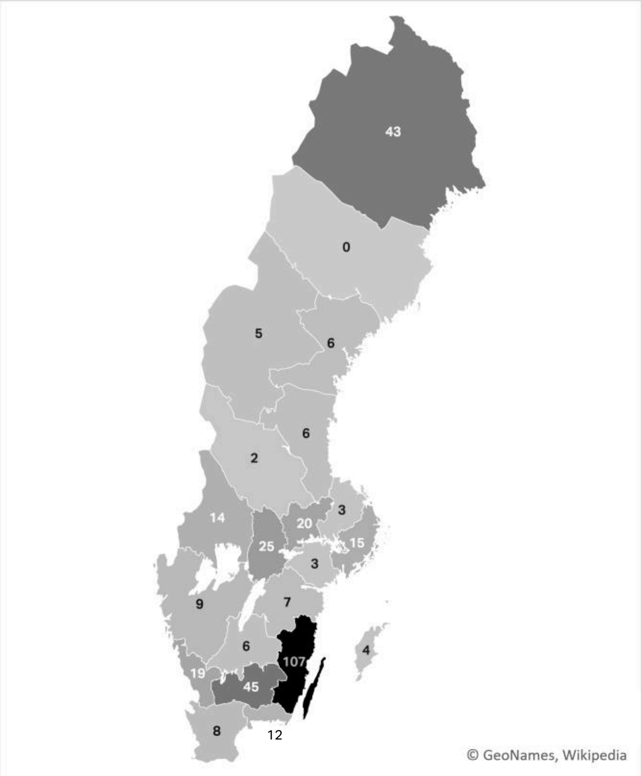


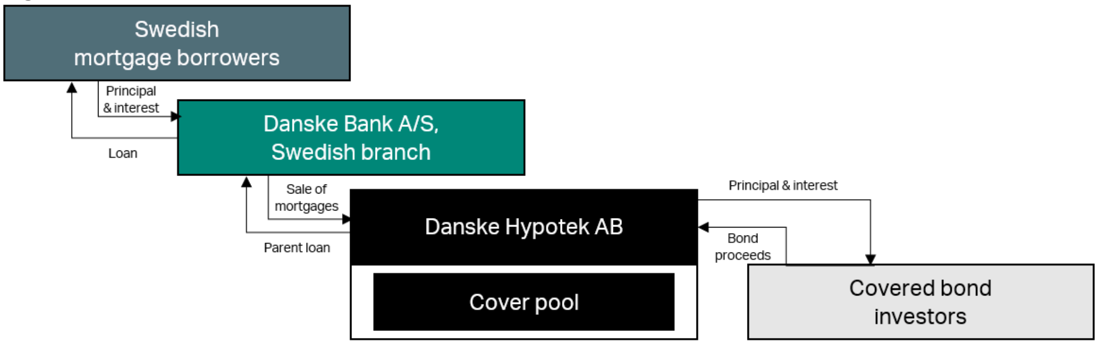
Figure 6. Average commercial and multi-family mortgage loan per property by region (SEKm), 31 Dec. 2023



COMPANY PROFILE

Danske Hypotek is a wholly owned Swedish subsidiary of Danske Bank and has been authorised to issue covered bonds in Sweden since 2017. The company was created to provide access to Sweden's covered bond market and to finance Danske Bank's Swedish retail and corporate mortgage loans in the same benchmark market as its competitors. All of the loans financed by Danske Hypotek are acquired from Danske Bank's Swedish branch, as Danske Hypotek itself does not conduct any new lending business.

Figure 7. Covered bond structure



QUALITATIVE ASSESSMENT

Qualitative assessment 'aaa'

NCR's qualitative assessment of Danske Hypotek's covered bonds is 'aaa', reflecting the issuer rating on the company and the notches of support described below. Our qualitative assessment indicates a very low likelihood that the cover pool will become a standalone entity, and a high likelihood that bondholders will receive timely coupon and principal payments.

Issuer rating of 'A'

The repayment capacity for covered bonds is linked to the credit quality of the issuer and the issuer's banking group. Our 'A' issuer rating on Danske Hypotek reflects our current 'a' credit assessment of Danske Bank and the company's role as a 'vital' entity within the group structure. The outlook on our issuer rating on Danske Hypotek is stable, reflecting our view of Danske Bank's creditworthiness.

Senior unsecured issue rating one notch above issuer rating

As of year-end 2023, Danske Bank had DKK 79bn in senior non-preferred debt instruments with a maturity of over one year. These instruments represent 9.5% of the group's risk exposure amount (REA) and 35% of its minimum subordination requirement for own funds and eligible liabilities (MREL) buffers. We therefore believe that the senior non-preferred instruments are likely to provide a meaningful buffer for Danske Bank's senior unsecured creditors in the event of resolution and thereby benefit all group subsidiaries.

Danske Hypotek's liability structure consists primarily of covered bonds, which are already excluded from bail-in according to the EU's Bank Recovery and Resolution Directive, and loans directly from Danske Bank. We note that Danske Bank's senior loans to Danske Hypotek are subordinated to covered bondholders, giving investors priority claims on all mortgage loans transferred to Danske Hypotek, whether or not such loans are eligible for the cover pool. In our view, the bail-in of senior non-preferred instruments in the event of a resolution of Danske Bank is likely to provide material additional support for Danske Hypotek, which we reflect in an additional notch above the issuer rating in our 'A+' senior unsecured rating.

We consider covered bonds to have structural priority above other liabilities, given the preferential claim of the cover pool over a majority of the company's loan assets in the event of default. As a result, we add an additional notch of uplift to the covered bond ratings in comparison with our issue rating on the company's senior unsecured debt, even if a company has no such instruments outstanding. This reflects the BRRD's explicit definition of covered bonds as having priority claim over senior unsecured debt obligations in the default hierarchy of financial institutions.

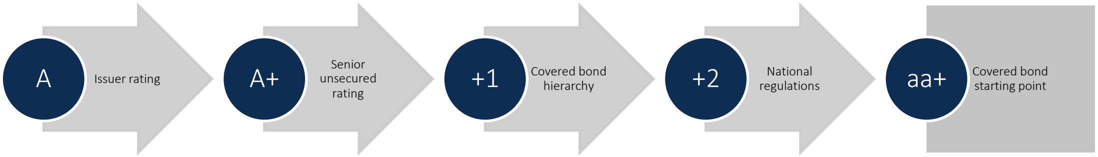
The creditor hierarchy for Swedish banks is as follows:

1. Secured or collateralised obligations, including covered bonds.
2. Guaranteed deposits.
3. Unguaranteed household and SME deposits.
4. Senior preferred debt and wholesale and institutional deposits.
5. Senior non-preferred debt.
6. Subordinated debt.
7. Tier 2 capital instruments.
8. Additional Tier 1 instruments.
9. Equity.

National regulations provide two-notch uplift to covered bond ratings

We consider the legal framework for Swedish covered bonds as supportive of the creditworthiness of covered bonds secured by residential and commercial mortgage loans, adding an additional two notches to the rating on Danske Hypotek's covered bonds and resulting in a covered bond starting point of 'aa+'.

Figure 8. Covered bond starting point



Swedish covered bonds are governed by the Covered Bonds Issuance Act (*Lag (2003:1223) om utgivning av säkerställda obligationer*) as well as the Swedish Financial Supervisory Authority's regulations and general guidelines (FFFS 2013:1). On 8 Jul. 2022, Sweden implemented its version of the EU's updated covered bond directive.

The Swedish Covered Bonds Issuance Act ensures:

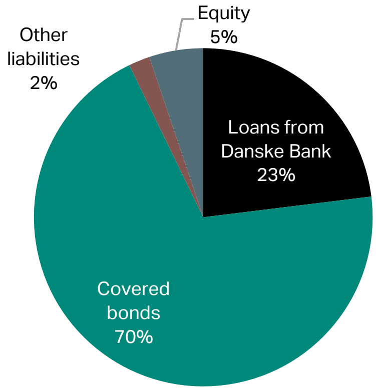
- the bankruptcy remoteness of the cover pool and the maintenance of an accurate register of pool assets, including derivative agreements;
- covered bond investors' preferential claim to pool assets;
- covered bond investors' pari passu claim with other senior creditors to additional assets;
- independent monitoring of the cover pool appointed by the Swedish Financial Supervisory Authority;
- a liquidity buffer requirement covering 180 days of net outflows using extended maturity dates for extendable maturity (soft bullet) bonds;
- soft bullet bonds are only extended if approved by the Swedish regulator to avoid insolvency;
- acceptance of lower-rated derivative counterparties, where necessary, to avoid counterparty concentrations; and
- the bankruptcy administrator's authority to borrow and issue derivatives, as well as sell assets, if necessary to maintain a balance between incoming and outgoing cash flows.

In addition, the law sets out the following conditions for cover pool assets:

- property exposures should be located in Sweden or other states of the European Economic Area;
- maximum loan to value (LTV) of 80% for residential mortgages and 60% for holiday properties included as eligible security;
- maximum LTV of 60% for commercial and agricultural mortgages included as eligible security, which can be increased to 70% if overcollateralisation in the cover pool exceeds 10% (agricultural mortgages are defined as either primarily residential or commercial);
- the amount of additional liquid security that can be pledged in the cover pool is 20%; and
- the nominal value of eligible pool assets must exceed bond liabilities by 2%, i.e. overcollateralisation of 2%.

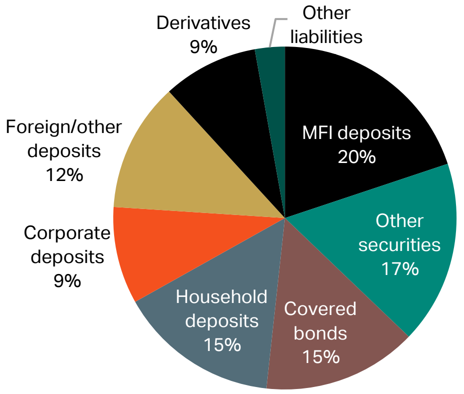
In addition to strong national regulations, covered bonds are a significant part of the Swedish financial fabric and constitute a material portion of domestic bank financing. The country had over SEK 2.6 trillion in outstanding covered bonds as of February 2024, and they are an important source of stable funding. The long-term proportion of covered bond financing fell below 15% of outstanding liabilities in early 2022 as capital markets tightened and the share of interest rate derivative assets increased. The trend reversed in late 2022, and banks have steadily increased their share of covered bond financing to 14.3% as of February 2024. We expect the long-term proportion of covered bond financing to be around 15%.

Figure 9. Danske Hypotek liabilities, year-end 2023



Source: company.

Figure 10. Swedish monetary financial institutions' liabilities and equity, Feb. 2024



Source: Statistics Sweden.

High likelihood of resolution supports 'aaa' qualitative assessment

The likelihood of resolution is an important component in NCR's evaluation of the likelihood of Danske Hypotek's cover pool being run down by an administrator without the support of Danske Hypotek or Danske Bank.

We consider a single point of entry resolution for Danske Bank a near certainty under current European law, as well as the explicit identification of the group as a systemically important financial institution in Denmark. We would expect a resolution for Danske Bank to result in Danske Hypotek maintaining its current relationship with the parent as the originator, internal swap party and parent loan provider.

In our view, Danske Hypotek would also have a very high likelihood of resolution as a standalone Swedish mortgage institution. While not explicitly identified as a systemically important financial institution in Sweden, the Swedish resolution authority, the Swedish National Debt Office, has identified a specified minimum requirement for own funds and eligible liabilities for Danske Hypotek of 6% of total liabilities and own funds since 1 Jan. 2024. We note that the loan from Danske Bank is included in Danske Hypotek's MREL, ensuring that Danske Hypotek is well over its regulatory MREL requirement. We also believe that a default by Danske Hypotek would have a significant negative impact on the Swedish covered bond market, given over SEK 100bn outstanding covered bonds, and believe that the company's residential mortgage assets would be highly likely to be part of a restructuring if resolution measures were to fail.

Our evaluation of the impact of resolution compares the implicit default frequency of the covered bond starting point with the probability of the covered bonds being protected in a resolution scenario for Danske Bank, which is 95%, the maximum level under our criteria. The resulting qualitative assessment is presented in Figure 11.

Given the covered bond starting point ('aa+') and the 95% probability of resolution for Danske Hypotek, the qualitative assessment is 'aaa'. We expect the qualitative assessment of Danske Hypotek's covered bonds to remain 'aaa', even if Danske Hypotek were to be downgraded by up to four notches, all else being equal. If the issuer rating were to fall by five notches or more, it could still be possible for the security of the cover pool to provide additional uplift to the covered bond ratings.

Figure 11. Qualitative assessment based on covered bond starting point and probability of resolution or restructuring

COVERED BOND STARTING POINT	95%	67%	33%	0%
aaa	aaa	aaa	aaa	aaa
aa+	**aaa**	aaa	aaa	aa+
aa	aaa	aaa	aa+	aa
aa-	aaa	aa+	aa	aa-
a+	aaa	aa	aa-	a+
a	aaa	aa	a+	a
a-	aa+	aa-	a	a-

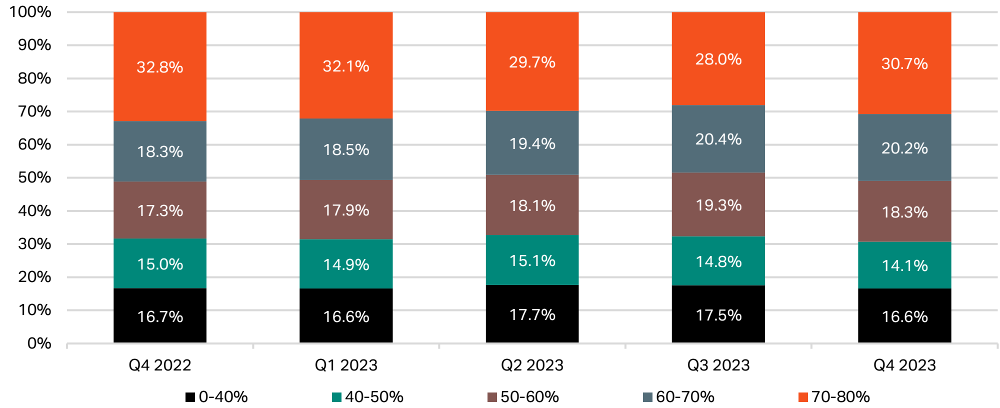
Source: NCR Covered Bond Rating Methodology.

COVER POOL ANALYSIS AND STRESS TESTING

Our cover pool analysis and stress testing support the 'AAA' rating on Danske Hypotek's covered bonds. Given the 'aaa' qualitative assessment, the analysis of the cover pool is primarily to provide further information on the details and sensitivities of the cover pool. We have used loan, property and borrower level details as well as data from Danske Hypotek's European Covered Bond Council Harmonised Transparency Templates (ECBC HTT) to analyse pool assets and conduct sensitivity analysis, credit risk and cash flow stress testing on the cover pool according to our criteria.

NCR has no overcollateralisation requirement in its methodology, but stresses pool assets to determine the ability to fulfil commitments as a standalone entity. Accordingly, overcollateralisation is a key component of an issuer's ability to repay bondholders in full in the event of a rundown.

Figure 12. Share of pool by borrower level LTV, last five quarters

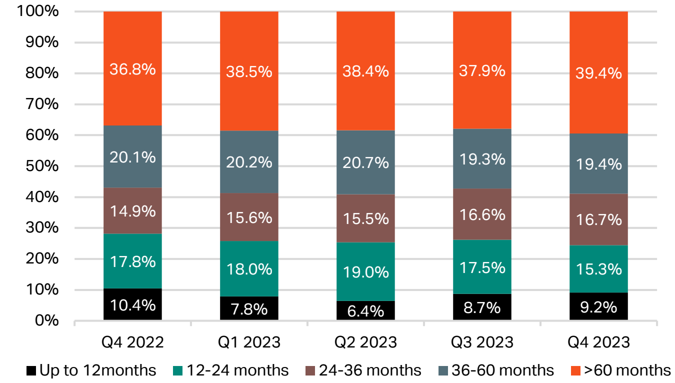


Source: company. Entire eligible loan amount in respective bucket based on borrowers' LTV.

Increase in multi-family housing materially changes pool metrics

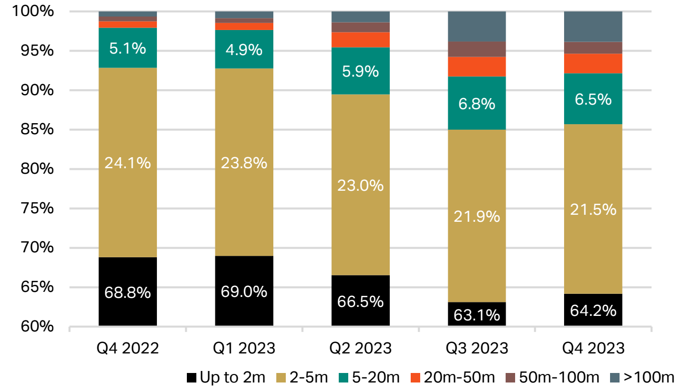
The following charts provide an overview of the characteristics of the cover pool assets. As of year-end 2023, the pool included SEK 123.5bn in eligible residential mortgage loans, SEK 15.5bn in multi-family housing loans and SEK 0.5bn in other commercial mortgages. In addition, at year-end 2023 Danske Hypotek had SEK 2.7bn in additional net loans, to which covered bondholders have priority claims, given that Danske Bank's senior claims are subordinated to covered bondholders.

Figure 13. Share of pool by loan seasoning, last five quarters



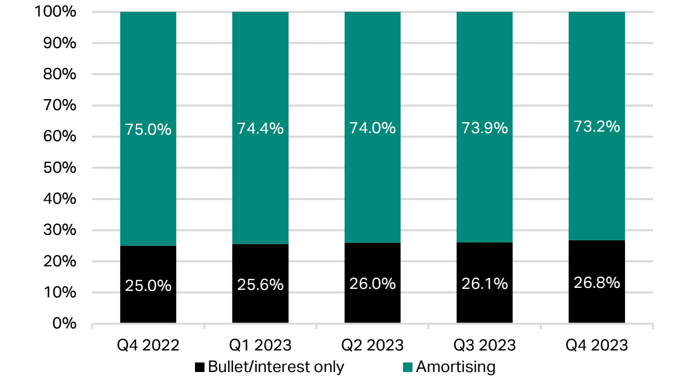
Source: company.

Figure 14. Share of pool by loan size (SEK), last five quarters



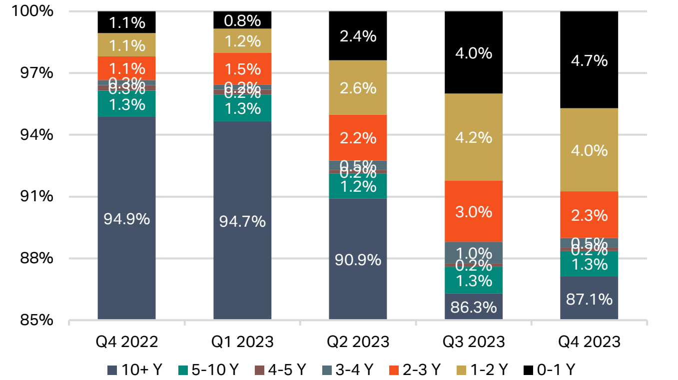
Source: company.

Figure 15. Share of pool by payment profile, last five quarters



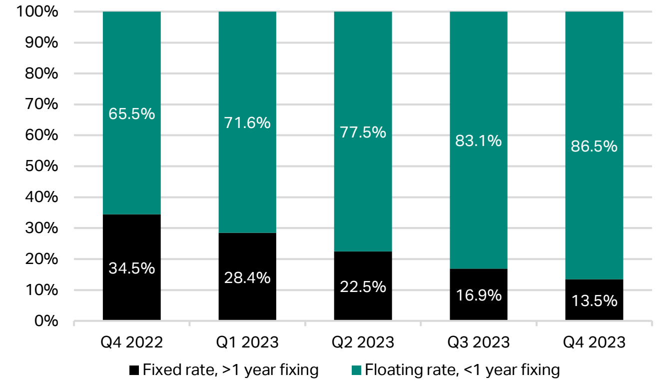
Source: ECBC HTT.

Figure 16. Share of pool by maturity, last five quarters



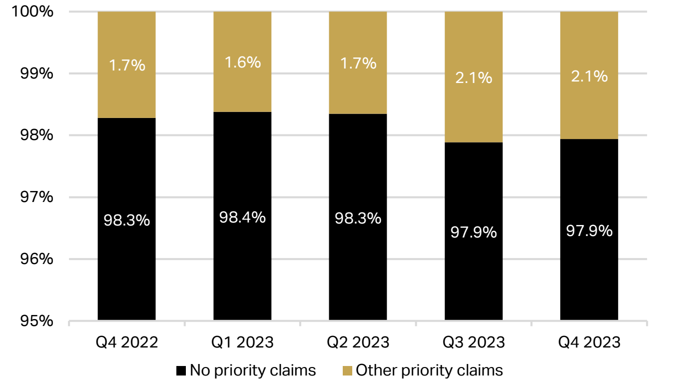
Source: company.

Figure 17. Share of pool by interest rate, last five quarters



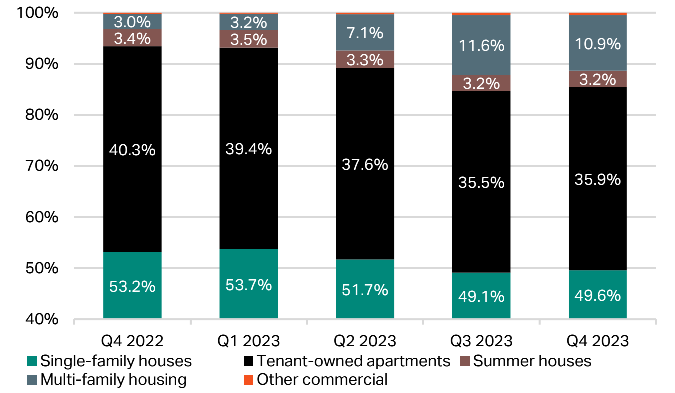
Source: company.

Figure 18. Share of pool by priority claims, last five quarters



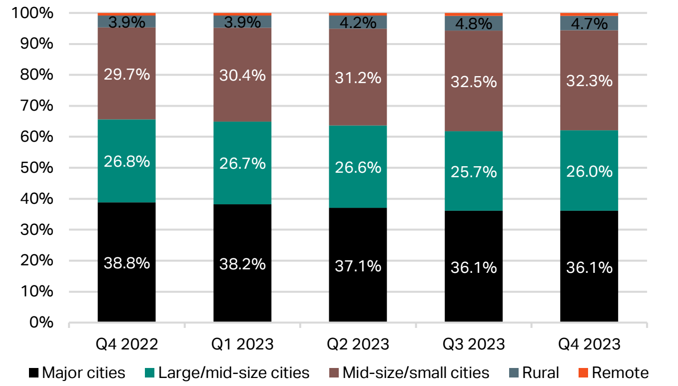
Source: company.

Figure 19. Property type, last five quarters



Source: company.

Figure 20. Region class, last five quarters



Source: company, NCR.

Stress testing

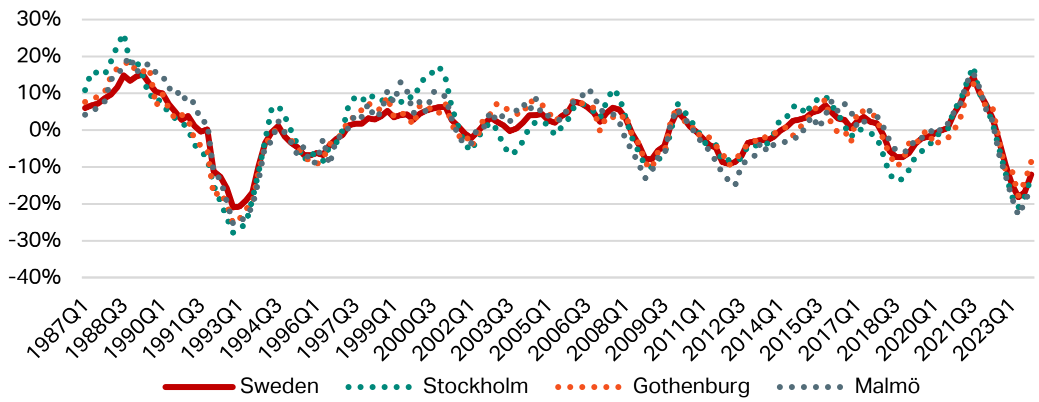
Our standalone stress testing of the cover pool assumes that all forms of external support for the pool are exhausted and that only the underlying assets can provide enough liquidity to make coupon and principal payments. This analysis begins with the assumption that the issuer and/or banking group is being liquidated and administrators have committed to winding down the pool and selling necessary assets at a discount to ensure investors receive timely payment. We conduct credit risk and cash flow stress testing on the cover pool assets using five increasingly difficult stress scenarios – Level 1 to Level 5 – with Level 5 being the most severe. Where the qualitative assessment is below 'aaa', the varying levels of stress can determine whether additional credit support is available from pool assets and reflected in additional notches in the covered bond ratings.

For Danske Hypotek, with a qualitative assessment of 'aaa', the stress test analysis demonstrates the potential for further credit support in the highly unlikely event of the cover pool becoming a standalone entity.

Credit risk stress tests show lower projected losses in all scenarios

Since 1987, average domestic housing prices have increased by 5.7% annually, according to Statistics Sweden's one- and two-dwelling index. Housing prices have stabilised following the steep decline from the first half of 2022 to the autumn of 2023 (see Figure 21). We expect prices to continue to rise over the next two years due to falling interest rates, pent-up demand and low activity in the last two years. Looking ahead, we expect growth rates closer to the long-term compound annual growth rate (CAGR).

Figure 21. Sweden annual housing price growth adjusted for CAGR, 1987–2023



Source: Statistics Sweden, NCR.

NCR's credit risk stress testing begins with standard assumptions (see Figure 22). Since Q4 2022, we have based our cover pool stress scenarios on the assumption that Swedish housing prices are 5–15% below their long-term trend levels. Recent decreases in housing prices have increased the loan-to-value ratio in Danske Hypotek's portfolio, which we expect to remain steady due to moderate price improvements over the next two years. Based on our methodology, the current pricing situation results in a 15–35% fall in residential property prices in our stressed scenarios.

As of year-end 2023, Danske Hypotek has transferred about SEK 16bn in multi-family housing and other commercial mortgages from Danske Bank to its own cover pool. We expect multi-family housing loans to increase by year-end 2024 as more loans are transferred.

Multi-family rental housing carries the default risk of the property owner and their ability to service their bank loans. While property owners can raise rental rates, the rates in Sweden are often regulated and dependent on investments to raise the standard of the building. The ability to service the debt on multi-family housing is also dependent on maintaining low vacancies and stable rental income. The strength and available alternatives in the local rental market and attractiveness of the underlying asset therefore play a larger role in the default risk for these types of loans. In terms of expected losses (see Figure 23), we assume that the one-year probability of default for cooperative housing loans is 0.2% ('BBB') and that the one-year probability of default of other commercial loans and multi-family housing exposures is 1.8% ('BB' according to NCR rating principles). We apply residential property stress levels to cooperative housing loans and commercial property stress levels to other commercial loans.

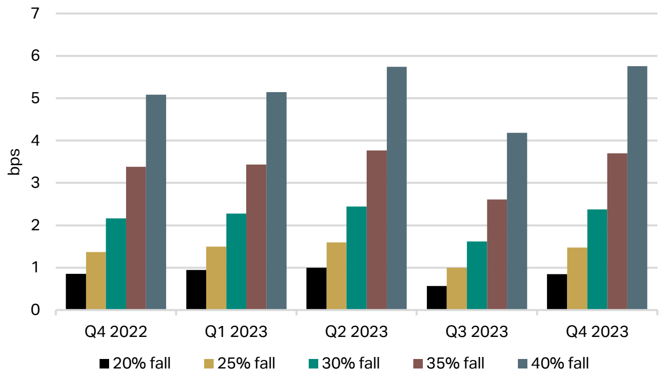
Figure 22. Standard asset quality assumptions used in credit risk stress testing, %

	Residential property, probability of default*	Residential property price fall	Commercial property probability of default* (3x)	Commercial property price fall (1.25x)
Level 1	4.0	15.0	12.0	18.8
Level 2	5.2	20.0	15.7	25.0
Level 3	6.9	25.0	20.6	31.3
Level 4	9.0	30.0	27.0	37.5
Level 5	11.8	35.0	35.4	43.8

*Half of instances of default are assumed to result in an executive auction at discounted prices.

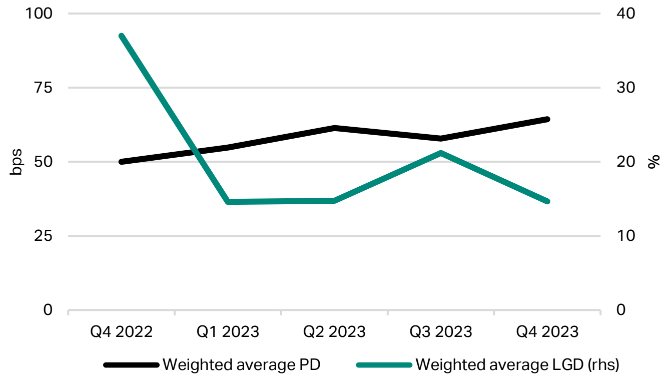
We also make adjustments to default assumptions to reflect foreclosure costs and the concentration of the portfolio, and to stressed property valuations based on the region class of the specific property. The addition of multi-family housing loans has increased the distribution of geographical exposures and reduced the share of loans in Stockholm from 43% to 40%. As a result, we have lowered our concentration adjustment to 2% from year-end 2023, reflecting the relative geographic concentration of Danske Hypotek's loan assets compared with Swedish peers' cover pools. For more details of the stress assumptions, see *Appendix 1: Analysing the Cover Pool* in our *Covered Bond Rating Methodology*.

Figure 23. Expected loss as a share of cover pool loans, based on actual portfolio composition and NCR stress test, last five quarters



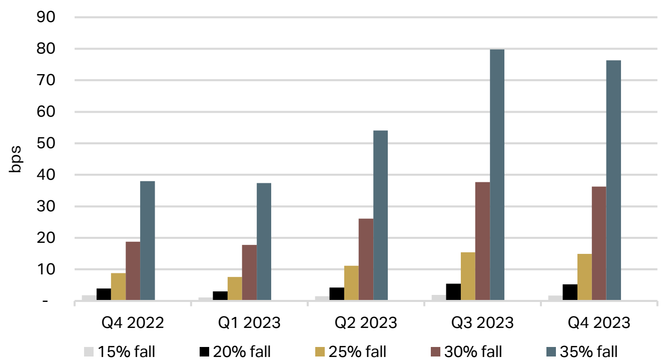
Source: company, NCR.

Figure 24. Weighted-average probability of default (PD) and loss given default (LGD) of cover pool, last five quarters



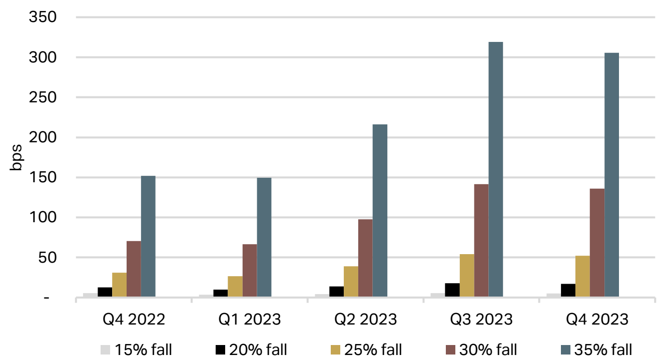
Source: company, NCR.

Figure 25. One-year credit loss as a share of cover pool loans, based on actual portfolio composition and NCR stress test, last five quarters



Source: company, NCR.

Figure 26. Multi-year credit loss as a share of cover pool loans, based on actual portfolio composition and NCR stress test, last five quarters



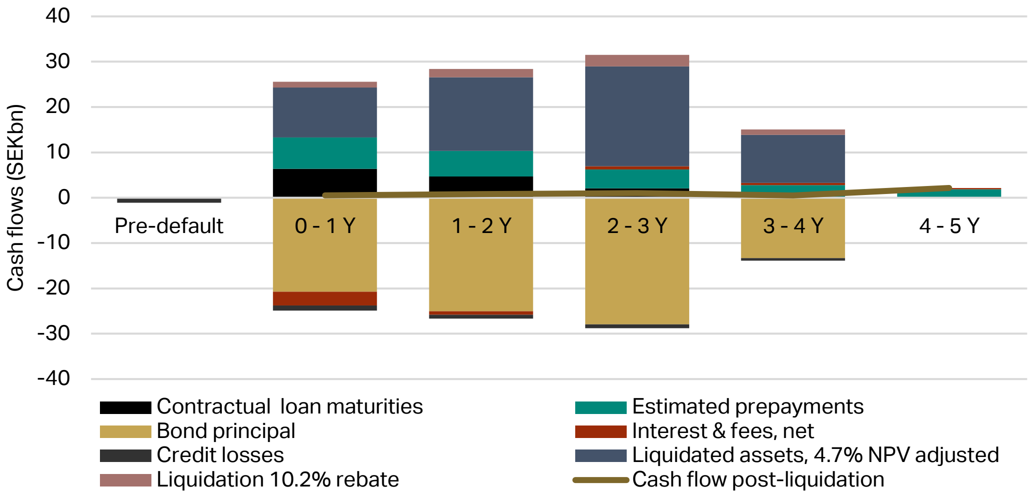
Source: company, NCR.

Cash flow stress test shows shortage in year five of rundown

The stressed losses and non-performing loans are included in our cash flow stress test based on an assumption of the portfolio being run down by an administrator and outstanding bonds being repaid by selling pool assets at a discount. Due to the high likelihood of a resolution, we do not view this scenario as likely for Danske Hypotek. Our stress analysis shows no cash flow shortfall, even in our most extreme scenario (Level 5), with a slight surplus in the fifth year of rundown (see Figure 27). The scenario assumes prepayments of 5% and repayment of performing loans at maturity. It also assumes that net interest margins on performing loans fall from 0.7% to 0%.

The outcome of this analysis is theoretical, given the assumption that the stress is immediate and based on current assets and outstanding bonds. The stress scenario is primarily dependent on our assumptions about the severity of discount rates and the liquidation rebates on assets sold. Interest and fees have only a modest impact on our analysis of Danske Hypotek's stressed cash flows. Interest rate risk is mitigated by the relatively short-term nature of interest rate fixing in the mortgage book and the company's policy of swapping all covered bond interest at floating rates.

Figure 27. Stressed cash flows in NCR's level 5 scenario for Danske Hypotek as of 31 Dec. 2023



Source: company NCR.

ADDITIONAL FACTORS

Counterparty risk from intra-group interest rate swaps

Swaps in the cover pool serve to reduce the interest rate risk between the pool and the outstanding bonds by swapping all bond interest payments to the three-month Stockholm Interbank Offered Rate. The maturities of the swap agreements are matched to the outstanding maturities of the bonds. Danske Hypotek's primary interest rate swap counterparty is Danske Bank, which fulfils our criteria in terms of the creditworthiness of swap counterparties. We note that Danske Bank is obliged to find a replacement counterparty at its own expense if its applicable public counterparty rating (as defined in the bond terms) falls below 'A-'. We also consider that Danske Bank and Danske Hypotek are likely to be part of the same resolution process, which is likely to prioritise the continuity of the derivatives within the cover pool. In view of this, we do not adjust the rating on the covered bonds, despite the concentration in Danske Hypotek's swap partners.

The Swedish covered bond act allows issuers to use bank counterparties ranked at the EU's Credit Quality Step 3 (broadly similar to a public credit rating at the 'BBB' level). According to our criteria, we could adjust covered bond ratings to reflect the risk of overreliance on derivative counterparties with public credit ratings of 'BBB+' or lower (or equivalent NCR credit assessments) outside the issuer's banking or ownership group.

DANSKE HYPOTEK ISSUER RATING

Our 'A' long-term issuer rating on Danske Hypotek AB (publ) reflects the operating environment for Swedish mortgage lenders, as well as Danske Hypotek's strong risk-adjusted earnings, very low historical and projected loss performance, and low credit risk profile. It also reflects Danske Hypotek's role as a 'vital' subsidiary within the Danske Bank group and a permanent part of Danske Bank's long-term strategy in its core Swedish market.

STABLE OUTLOOK

The outlook is stable, reflecting our credit assessment of Danske Bank. Upside to the issuer rating on Danske Hypotek remains constrained by our 'a' credit assessment of Danske Bank. Given our view of Danske Hypotek as 'vital' to Danske Bank, we could revise our rating on the company due to changes in our credit assessment of the parent.

POSITIVE RATING DRIVERS:

- Improvement in NCR's view of Danske Bank group's creditworthiness.

NEGATIVE RATING DRIVERS:

- Deterioration in NCR's view of Danske Bank group's creditworthiness.

Figure 28. Key credit metrics, 2020–2026e

%	2020	2021	2022	2023	2024e	2025e	2026e
Net interest margin	1.1	1.0	0.9	0.6	0.8	0.9	0.9
Loan losses/net loans	-0.03	0.01	0.00	0.00	0.02	0.02	0.02
Pre-provision income/REA	3.4	3.3	2.4	1.8	2.1	2.3	2.5
Cost to income	12.0	10.1	22.6	24.1	20.2	17.2	16.3
Return on ordinary equity	15.1	14.3	9.9	7.4	8.6	10.0	10.1
Loan growth	21.0	6.0	5.8	8.0	10.5	4.5	3.0
CET1 ratio	17.5	18.3	19.5	19.0	17.7	18.6	19.8
Tier 1 ratio	17.5	18.3	19.5	19.0	17.7	18.6	19.8

Source: company, NCR. e–estimate. All metrics adjusted in line with NCR methodology. CET1–common equity Tier 1.

RATING RATIONALE

Operating environment for Sweden 'a-'

Our assessment of the Swedish banking market reflects our expectations of a resilient banking market, despite higher interest rates and expectations of increasing credit losses. Our view takes account of banks' strong earnings and stable, yet weakening, labour markets. Residential property prices have stabilised after declining from mid-2022 to mid-2023, stabilising the loan-to-value ratio in Danske Hypotek's loan book. Despite higher borrowing costs, we project modest credit losses in residential mortgage lending over the next few years.

Risk appetite assessment 'a'

Danske Hypotek has benefited from group investments in compliance and risk governance, which have repositioned Danske Bank as a leader in this respect. Danske Hypotek's pays for administrative services provided by the group via various service level agreements, which form the core of Danske Hypotek's own governance model, including risk oversight and internal audit processes. Danske Hypotek also maintains dedicated full-time resources in key functions such as credit risk, financial accounting, operations and treasury.

Danske Hypotek's capital position is robust; the company had a common equity Tier 1 (CET1) ratio of 19.0% at year-end 2023. We project that the ratio will fall in 2024 due to additional multi-family housing loans with 35% risk weights to the cover pool. We expect margins to improve from current levels and for capital generation to exceed growth in 2025 and 2026 due to low retail mortgage growth and a lack of dividend payments. The regulatory capital requirement was 14.3% at year-end 2023, and the company maintains access to additional capital from the group when necessary and can sell loans back to Danske Bank to reduce its capital requirements, which provides additional flexibility.

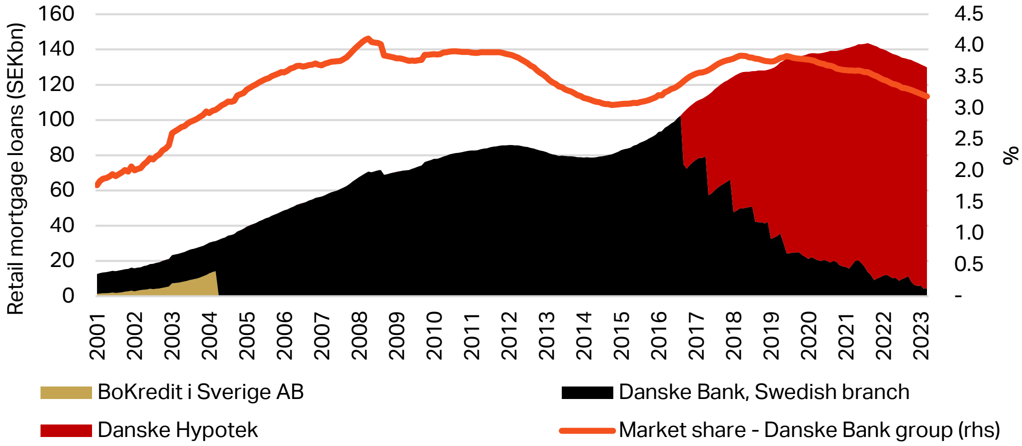
We view covered bonds as a stable funding source, despite a relative concentration in outstanding benchmark issues. We believe the tap issuance and early buyback system used in Sweden, and the country's history of supporting liquidity in the covered bond market, mitigate the maturity mismatch in assets and liability. We view Danske Hypotek's loans from the group as a flexible and accessible secondary financing source, ensuring the fulfilment of regulatory liquidity coverage and net stable funding ratios. All outstanding bonds are denominated in Swedish kronor, matching the assets.

Danske Hypotek's credit risk profile is well reflected by the regulatory risk weights for residential mortgages (25% floor) and multi-family housing (35%). The addition of multi-family housing increases single-name concentrations somewhat, but the loan book continues to consist largely of residential mortgages in Sweden's largest cities, supporting the relative liquidity of the collateral (see Figure 19 and Figure 20).

Competitive position scores 'bbb+'

Danske Bank originally entered the Swedish market as a branch operation in 1995. We consider Danske Hypotek to be a challenger in the Swedish residential mortgage market, and, despite its national presence, we note that it is relatively concentrated in Stockholm (see Figure 3). Combined with residential mortgage loans at Danske Bank's Swedish branch, the group's market share was 3.2% in February 2024 and has fallen steadily since 2020. The addition of multi-family housing diversifies the company's business diversity somewhat, offsetting the impact of recent market share deterioration.

Figure 29. Danske Bank Swedish retail mortgage market share, Dec. 2001–Feb. 2024



Source: Statistics Sweden

Performance indicators score 'a+'

We view Danske Hypotek's earnings and loss performance metrics as strong. Mortgage margins in Sweden remain under intense pressure due to lower loan growth and higher financing costs. The company's expenses are dominated by an internal cost allocation from Danske Bank, and we expect cost efficiency to improve as loan volumes increase and margins recover. The result is improved risk-adjusted earnings, though not to the very high level prior to interest rate increases.

Danske Hypotek's loss performance is supported by a propensity among Swedish borrowers to prioritise payments on their residential mortgages, given strong creditor rights. We expect Danske Hypotek to maintain a clean cover pool by selling non-performing loans back to Danske Bank before they become ineligible for the pool (60 days past due). As of year-end 2023, the bank had 17bps in net Stage 3 non-performing loans, down from 69bps at the end of 2021, which resulted from borrowers' use of a temporary relaxation of amortisation payments during the pandemic. We do not expect material credit provisions in our forecast, given the company's ability to transfer loans to Danske Bank.

Neutral aggregate ESG impact

Environmental, social and governance (ESG) factors are considered throughout our analysis where material to the credit assessment. On aggregate, we view Danske Hypotek's ESG profile as having a neutral impact on its creditworthiness.

Danske Hypotek's role in the group's ESG strategy is defined in Sweden by its role within the Swedish branch and group-wide commitments to sustainability. Danske Bank has established clear ESG goals through 2030 to reduce its climate footprint from lending, asset management, insurance activities and own operations. The group has also outlined focus areas for nature and biodiversity, as well human rights and social impact, to ensure alignment of customers and vendors with the bank's sustainability objectives.

Figure 30. Priority ESG factors

Issue/area	Risk/opportunity	Impacted subsections (impact on credit assessment*)
Control of sustainability issues	Proactive and rigorous measures mitigate regulatory and reputational risks and give credibility to sustainability profile.	Risk governance (+) Credit risk (0)
Sustainable/green bond framework	Aims to become a green bond issuer now that it has established itself as a benchmark covered bond issuer.	Competitive position (0)
Physical climate risk to collateral	Climate-related damage to real-estate collateral (closely linked to supervision of insurance). Longer-term term effects on market values in flood risk areas.	Credit risk (-) Loss performance (0)
Anti-money laundering capacity	Risk of sanctions and fraud due to insufficient control of customers.	Risk governance (0)

*Defined according to a 5-step scale ranging from double minus (--) to double plus (++), with (--) representing the most negative impact and (++) the most positive. See ESG factors in financial institution ratings.

Ownership support neutral

We view Danske Hypotek as a 'vital' entity within the Danske Bank group. However, we currently assess Danske Bank at 'a', which is in line with our standalone credit assessment of Danske Hypotek.

Danske Hypotek is partly financed by Danske Bank and is highly integrated within the group's Swedish operations. In addition, we expect any financial resolution (as defined by the EU's Bank Recovery and Resolution Directive) involving Danske Bank to result in the Swedish subsidiary maintaining its current relationship with the parent. For this reason, Danske Hypotek is not eligible to be rated above the level of our credit assessment of the parent.

The short-term rating is 'N2', in line with our definition for the long-term rating level ('A').

METHODOLOGIES USED

(i) Financial Institutions Rating Methodology, 14 Feb. 2024.
(ii) Covered Bond Rating Methodology, 14 Feb. 2024.
(iii) Rating Principles, 14 Feb 2024.
(iv) Group and Government Support Rating Methodology, 14 Feb. 2024.

Figure 31. Danske Hypotek key financial data, 2020–2023

Key credit metrics (%)	FY 2020	FY 2021	FY 2022	FY 2023
INCOME COMPOSITION				
Net interest income to op. revenue	106.4	104.8	108.1	99.3
Net fee income to op. revenue	-2.1	-1.8	-2.3	-2.8
Net trading income to op. revenue	-4.4	-6.0	-6.3	3.3
Net other income to op. revenue	0.0	3.0	0.4	0.2
EARNINGS				
Net interest income to financial assets	1.1	1.0	0.9	0.6
Net interest income to net loans	1.1	1.1	0.9	0.7
Pre-provision income to REA	3.4	3.3	2.4	1.8
Core pre-provision income to REA (NII & NF&C)	3.5	3.4	2.5	1.7
Return on ordinary equity	15.1	14.3	9.9	7.4
Return on assets	0.7	0.7	0.5	0.4
Cost-to-income ratio	12.0	10.1	22.6	24.1
Core cost-to-income ratio (NII & NF&C)	11.5	9.8	21.3	24.9
CAPITAL				
CET1 ratio	17.5	18.3	19.5	19.0
Tier 1 ratio	17.5	18.3	19.5	19.0
Capital ratio	17.5	18.3	19.5	19.0
REA to assets	25.6	27.1	26.2	27.1
Dividend payout ratio				
Leverage ratio	0.0	0.0	0.0	0.0
GROWTH				
Asset growth	22.0	6.1	7.4	6.9
Loan growth	21.0	6.0	5.8	8.0
Deposit growth				
LOSS PERFORMANCE				
Credit provisions to net loans	-0.03	0.01	0.00	0.00
Stage 3 coverage ratio	2.55	4.26	7.83	17.30
Stage 3 loans to gross loans	0.23	0.72	0.48	0.21
Net stage 3 loans to net loans	0.22	0.69	0.44	0.17
Net stage 3 loans/ordinary equity	4.55	13.15	8.02	3.15
FUNDING & LIQUIDITY				
Loan to deposit ratio				
Liquid assets to deposit ratio				
Net stable funding ratio	124.0	121.0	120.0	122.0
Liquidity coverage ratio	1192.0	628.0	3085.0	1486.0

Key financials (SEKm)	FY 2020	FY 2021	FY 2022	FY 2023
BALANCE SHEET				
Total assets	123,647	131,229	140,958	150,634
Total tangible assets	123,647	131,229	140,958	150,634
Total financial assets	123,628	131,209	137,102	147,893
Net loans and advances to customers	117,365	124,444	131,635	142,113
Total securities	4,800	4,657	4,544	4,661
Customer deposits	–	–	–	–
Issued securities	92,232	97,309	98,020	105,082
of which other senior debt	92,232	97,309	98,020	105,082
of which subordinated debt	–	–	–	–
Total equity	5,661	6,536	7,214	7,772
of which ordinary equity	5,661	6,536	7,214	7,772
CAPITAL				
Common equity tier 1	5,543	6,520	7,185	7,748
Tier 1	5,543	6,520	7,185	7,748
Total capital	5,543	6,520	7,185	7,748
REA	31,641	35,608	36,925	40,878
INCOME STATEMENT				
Operating revenues	1,119	1,242	1,106	919
Pre-provision operating profit	984	1,116	856	698
Impairments	-27	15	2	-5
Net Income	795	875	678	558

Source: company. FY–full year. YTD–year to date.

Figure 32. Danske Hypotek rating scorecard

Subfactors	Impact	Score
National factors	20.0%	a-
Regional, cross border, sector	-	-
Operating environment	20.0%	a-
Capital	17.5%	a
Funding and liquidity	15.0%	a+
Risk governance	5.0%	a
Credit risk	10.0%	a
Market risk	-	-
Other risks	2.5%	a
Risk appetite	50.0%	a
Competitive position	15.0%	bbb+
Earnings	7.5%	a+
Loss performance	7.5%	aa-
Performance indicators	15.0%	a+
Indicative credit assessment		**a**
Transitions		Neutral
Borderline assessments		Neutral
Peer calibration		Neutral
Stand-alone credit assessment		**a**
Material credit enhancement		Neutral
Rating caps		Neutral
Support analysis		Neutral
Issuer rating		**A**
Outlook		Stable
Short-term rating		**N2**

Figure 33. Capital structure ratings

Seniority	Rating
Covered bond	AAA
Senior unsecured	A+

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